No. 91-1677

In the Supreme Court of the United States

OCTOBER TERM, 1992

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE PETITIONER

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QUESTION PRESENTED

Whether the contribution of property to a defined benefit pension plan by the plan's sponsoring employer, in satisfaction of the employer's funding obligation, constitutes a prohibited "sale or exchange" of the property under 26 U.S.C. 4975.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-9a) is reported at 951 F.2d 76. The memorandum opinion of the United States Tax Court (Pet. App. 10a-17a) is reported at 60 T.C.M. (CCH) 1423.

JURISDICTION

The judgment of the court of appeals was entered on January 17, 1992. The petition for a writ of certiorari was filed on April 16, 1992, and was granted on October 5, 1992. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

STATUTES INVOLVED

Sections 404, 412, 4941, 4971, and 4975 of the Internal Revenue Code (26 U.S.C.) and Sections 302 and 406 of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1082 and 1106, are set forth, in pertinent part, at Pet. App. 45a-52a.

STATEMENT

1. During its taxable years ending June 30, 1983, through June 30, 1988, respondent Keystone Consolidated Industries, Inc., maintained several tax-qualified defined benefit pension plans.[1] The plans were subject to the funding requirements of Section 302 of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1082. See also 26 U.S.C. 412. Respondent funded the pension plans through contributions to the Keystone Consolidated Master Pension Trust. Pet. App. 2a.

On March 8, 1983, respondent contributed five truck terminals with a fair market value of $9,655,454 to the Pension Trust.[2] Respondent credited the fair market value of the truck terminals against its statutory funding obligation to its employees' defined benefit pension plans for its taxable years ending June 30, 1982, and June 30, 1983. In addition, on March 13, 1984, respondent contributed to the Pension Trust real property in Key West, Florida, having a fair market value of $5,336,751. Respondent credited the fair market value of the Key West property against its statutory funding obligation to the Pension Trust for the taxable year ending June 30, 1984. Neither the truck terminals nor the Key West property was encumbered by a mortgage. Pet. App. 11a-12a.

Respondent claimed deductions on its federal income tax returns under 26 U.S.C. 404 in the amount of the fair market value of the five truck terminals and the Key West property. Respondent also reported the difference between its basis in each property and the fair market value of the property as capital gain. Thus, for income tax purposes respondent treated the dispositions of the properties as "sale[s] or exchange[s]" of a capital asset. Pet. App. 12a; see 26 U.S.C. 1222.

Section 4975 of the Internal Revenue Code, which was added to Title 26 by ERISA, imposes a two-tier excise tax on specified "prohibited transactions" between a pension plan and a "disqualified person."[3] Among the

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[1] A defined *benefit* pension plan is a plan under which retirees receive a fixed amount per month, which is typically based on factors such as the retiree's prior salary and years of service. Such plans differ from defined *contribution* pension plans (such as profit sharing plans and stock bonus plans), under which employers typically contribute a percentage of their payroll or profits to individual accounts; employees participating in defined contribution plans are entitled to the amount in their individual accounts upon retirement. See 29 U.S.C. 1002(34) and (35). If either sort of plan qualifies for favorable tax treatment, the employer may deduct its contributions to the plan immediately, but the plan participants are not taxed until they receive distributions from the plan. See 26 U.S.C. 402(a)(1), 404(a)(1).

[2] Respondent had acquired the five truck terminals from a subsidiary of its principal shareholder. According to respondent's 1983 annual report, its long-range plan at the time it acquired the terminals was to dispose of them. Affidavit of James S. Stanis, Exh. A at 50-51. Two of the terminals were subject to exclusive listing agreements, calling for the payment of sales commissions of at least five percent, when respondent contributed them to the Pension Trust. *Id.*, Exhs. E.3, E.4.

[3] The first tier of the excise tax is five percent of the "amount involved," 26 U.S.C. 4975(a), while the second-tier is 100% of the "amount involved," 26 U.S.C. 4975(b). The "amount involved" is the greater of the fair market value of the property as given or

"disqualified person[s]" listed in the statute is the employer of the employees covered by a pension plan. 26 U.S.C. 4975(e)(2)(C). Among the transactions prohibited by Section 4975 is "any direct or indirect * * * sale or exchange * * * of any property between a plan and a disqualified person." 26 U.S.C. 4975(c)(1)(A). The Commissioner of Internal Revenue determined that respondent's transfers to the Pension Trust of the five truck terminals and the Key West property constituted prohibited "sale[s] or exchange[s]" of those properties under Section 4975(c)(1)(A), so that respondent was subject to the excise tax.[4] Respondent filed a petition in the Tax Court for a redetermination of its liability.

2. The Tax Court held in favor of respondent. It acknowledged that "there is a potential for abuse by allowing unencumbered property transfers to plans in satisfaction of minimum funding requirements." Pet. App. 14a. For example, such property may be overvalued. In addition, "the employer can save costs related to the sale of the asset by transferring it into a plan, rather than selling it outright." *Id.* at 15a. And the court recognized that the transfers of the properties constituted taxable events for income tax purposes. *Id.* at 14a. The court

received. 26 U.S.C. 4975(f)(4). The second tier tax ordinarily may be avoided by timely correction of the prohibited transaction upon completion of the litigation concerning the taxpayer's liability for that tax. See 26 U.S.C. 4961(a), 4963(b) and (e), 6213(a), 7481(a).

[4] The Commissioner determined deficiencies in respondent's first tier excise tax liability of $749,610 for its taxable year ending June 30, 1984, and of $482,773 for each of the taxable years ending June 30, 1983, and June 30, 1985, through June 30, 1988. The Commissioner also determined a deficiency in respondent's second tier excise tax liability for its taxable year ending June 30, 1988, in the amount of $9,655,454. Pet. App. 12a.

nevertheless concluded that the transfers were not "sale[s] or exchange[s]" under Section 4975(c)(1)(A), the provision prohibiting "any direct or indirect * * * sale or exchange * * * between a plan and a disqualified person."

In so holding, the court relied on 26 U.S.C. 4975(f)(3). That provision states that a transfer of property "by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien." In the Tax Court's view, "[s]ince section 4975(f)(3) specifically describes certain transfers of real or personal property to a plan by a disqualified person as a sale or exchange for purposes of section 4975, the definitional concerns of 'sale or exchange' are removed from the general definitions found in other areas of the tax law." Pet. App. 15a. Thus, the court held that Section 4975(f)(3) *limits* the reach of Section 4975(c)(1)(A), so that only transfers of encumbered property are prohibited, and accordingly rejected the Commissioner's argument that Section 4975(f)(3) *expands* the reach of the prohibited transaction rules. In the Commissioner's view, Section 4975(c)(1)(A) prohibits employers from contributing property rather than cash to fulfill their funding obligations to pension plans, while Section 4975(f)(3) additionally prohibits contributions of encumbered property to pension plans even if the contribution does not satisfy an obligation the employer owes the plan. Pet. App. 16a.[5]

The Tax Court further disagreed with the Commissioner's argument that by contributing property rather

[5] Contributions that do not fulfill funding obligations may occur in connection with defined contribution pension plans. See, *e.g.*, DOL Advisory Opinion 90-05A (Mar. 29, 1990) (App., *infra*, 4a-9a).

than cash to a plan, the employer can exert an unwarranted influence over the trust's investment policy. "If the asset is truly a poor investment," the court said, "the trustee, acting under its fiduciary capacity, can dispose of it." Pet. App. 15a. The court also noted that the Commissioner's distinction between transfers of property in satisfaction of a funding obligation (which are prohibited by Section 4975(c)(1)(A), in the Commissioner's view) and transfers of encumbered property (which are prohibited by Section 4975(f)(3), in the Commissioner's view, whether or not the contribution fulfills a funding obligation) had been rejected by the Tax Court in *Wood* v. *Commissioner*, 95 T.C. 364 (1990), rev'd, 955 F.2d 908 (4th Cir.), cert. granted, 112 S. Ct. 2937, cert. dismissed, 112 S. Ct. 3061 (1992); see Pet. App. 32a-44a.

3. The Fifth Circuit affirmed. Pet. App. 1a-9a. It read Section 4975(f)(3) as "implying that unless it is encumbered by a mortgage or lien, a transfer of property is not to be treated as if it were a sale or exchange." Pet. App. 5a. With respect to the Commissioner's argument that Section 4975(f)(3) was intended to expand the definition of "sale or exchange" to include transfers of encumbered property that do not fulfill funding obligations (*i.e.*, "voluntary" contributions), the court responded that, in its view, there is "no basis for this distinction between involuntary and voluntary transfers anywhere in the Code." Pet. App. 6a.[6]

[6] The court added that, in its opinion, the Commissioner's "distinction also makes no economic sense," because "when an employer makes a voluntary contribution to a plan, he effectively supplements the assets of the plan, receives a credit in his funding standard account, and thereby reduces the amount of mandatory contributions in future years." Pet. App. 6a. Those comments, while relevant to defined benefit pension plans, are inapplicable to defined contribution plans that do not mandate employer contributions; they are also inapplicable to contributions to defined contribution plans in excess of any mandatory amount. See pages 24-25, *infra*. The court also stated that "[i]f all transfers of property to a plan were to be treated as a sale or exchange" under Section 4975(c)(1)(A), then Section 4975(f)(3) "would be superfluous." Pet. App. 5a. That comment likewise ignores the existence of defined contribution pension plans. See pages 24-25, *infra*.

The court of appeals also stated that the potential for abuse posed by transfers of property in satisfaction of funding obligations is "already restrained" by the excise tax on accumulated funding deficiencies set out in 26 U.S.C. 4971. Pet. App. 8a. Moreover, it is "irrelevant," the court stated, that a transfer of property in satisfaction of an obligation is treated as a "sale or exchange" of property for income tax purposes, because Section 4975 "was not enacted to measure economic income." Pet. App. 7a.

Noting that both the IRS and the Department of Labor administer ERISA's prohibited transaction provisions,[7] the court acknowledged that both agencies "have found that similar transfers of property to pension funds were sales or exchanges under other sections of the Code and ERISA." Pet. App. 7a. But the court ruled that the Commissioner's views "are not entitled to any defer-

[7] A provision that is parallel to 26 U.S.C. 4975(c)(1)(A) was added to Title 29 by Section 406 of ERISA. That parallel provision prohibits a fiduciary from engaging in "a direct or indirect * * * sale or exchange * * * of any property between the plan and a party in interest." 29 U.S.C. 1106. The Department of Labor enforces the fiduciary duty provision, just as the IRS enforces Section 4975. Under the administrative division of responsibility, the Department of Labor has primary authority to construe both 26 U.S.C. 4975 and 29 U.S.C. 1106. See Reorg. Plan No. 4 of 1978, § 102, 92 Stat. 3790.

ence" because they had not been set out in a regulation. *Id.* at 8a. The court declined to defer to the Department of Labor either, because the Department's conclusion that transfers of property in satisfaction of funding obligations are prohibited was set out in an advisory opinion that was "binding only on the parties thereto." *Ibid.*[8]

SUMMARY OF ARGUMENT

A. The court of appeals misinterpreted 26 U.S.C. 4975. Like the parallel "prohibited transaction" provision enacted in Section 406(a)(1)(A) of ERISA, 29 U.S.C. 1106(a)(1)(A), Section 4975(c)(1)(A) broadly bars any "direct or indirect * * * sale or exchange" of property between a pension plan and a disqualified person such as respondent. For more than fifty years the courts have held that the transfer of property in satisfaction of a monetary obligation, as occurred in this case, constitutes a "sale or exchange" of the property under the income tax laws. It is appropriate to turn first to the settled meaning of the phrase "sale or exchange," and it makes sense to apply that interpretation in this case. By contributing the truck terminals and the Key West property in partial satisfaction of its funding obligation, respondent effectively sold the properties to the Pension Trust and applied the proceeds to its debt. Moreover, Congress drafted Section 4975(c)(1)(A) broadly, barring "any direct or indirect * * * sale or exchange," and it

[8] The Commissioner also appealed the Tax Court's decision in *Wood* v. *Commissioner, supra*, to the Fourth Circuit. That court reversed, stating that it "found itself in disagreement with the reasoning of the Fifth Circuit's decision" in this case. Pet. App. 28a.

surely intended that expansive language to apply in cases like this one.

A properly broad, literal construction of Section 4975(c)(1)(A) and Section 406 serves three important purposes. First, it prevents the overvaluation of contributed property from going undetected. Second, it prevents employers from transferring sales costs to the pension plans they sponsor. Third, a contrary construction of the prohibited transaction provisions would allow employers to circumscribe the trustees' discretion as to how the assets of a pension plan are to be invested.

The court of appeals reasoned that such problems were solved by 26 U.S.C. 4971, which imposes an excise tax on employers whose plans are underfunded. Pet. App. 8a. But Section 4975 serves the related, but different purpose of preventing plans from incurring losses on account of particular types of transactions that have a high potential for abuse. Moreover, if an underfunded plan is terminated while holding overvalued property or property that is difficult to sell, Section 4971 is of no use to the Pension Benefit Guaranty Corporation (PBGC), which will have to convert the property to cash. And participants and beneficiaries may be harmed if a terminated plan is holding troublesome property, because the PBGC does not insure 100% of pension benefits.

B. The court of appeals construed Section 4975(c)(1)(A) contrary to its broad language and the settled meaning of "sale or exchange" primarily because it thought that a narrow construction was mandated by Section 4975(f)(3). But Section 4975(f)(3) sets forth a special rule—providing that "[a] transfer [of] real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien"—that *broadens* the scope of

the prohibited transaction rules. Section 4975(f)(3) does not purport to give "sale or exchange" a narrow meaning, but instead provides that any contribution of encumbered property "shall be treated as" a sale or exchange.

The basis for the court's error was its failure to understand that employers may transfer property to defined *contribution* pension plans (see note 1, *supra*) in certain circumstances. The Department of Labor, which has primary responsibility for construing the parallel prohibited transaction provisions, has concluded that the transfer of unencumbered property to a defined contribution plan is not prohibited if the transfer is in addition to a cash payment satisfying the employer's obligation to the plan. DOL Advisory Opinion 90-05A (Mar. 29, 1990) (App., *infra*, 4a-9a). Therefore, contrary to the court of appeals' reasoning (Pet. App. 5a), a holding that Section 4975(c)(1)(A) prohibits contributions of property in satisfaction of funding obligations does not render Section 4975(f)(3) superfluous. Rather, Section 4975(f)(3) bars employers from contributing mortgaged property to pension plans, whether or not the contribution satisfies an obligation.

Respondent makes a slightly different argument to the effect that the government's construction of Section 4975(c)(1)(A) renders Section 4975(f)(3) superfluous (Br. in Opp. 8), and its argument is also erroneous. Respondent correctly notes that, under the applicable income tax rules, an employer generally must recognize gain upon making a contribution of property to a pension plan. Respondent goes on to argue that if "sale or exchange" is given meaning in Section 4975(c)(1)(A) by reference to the income tax rules, all transfers of property by employers to pension plans are prohibited by that provision. But Section 4975(c)(1)(A) prohibits transactions that are

sales or exchanges of property "between a *plan* and a disqualified person" (emphasis added). A transfer of property that does not satisfy a funding obligation is not such a transaction, and hence is not barred by Section 4975(c)(1)(A). The employer's gain on such a transaction is subject to tax under the income tax provisions because a voluntary transfer of property to a pension plan is a "sale or exchange" between the employer and *its employees*, not a pension plan.

Moreover, the government's construction of Section 4975 is sensible, while respondent's construction is not. In the government's view, Section 4975 prohibits transfers of property in satisfaction of an employer's funding obligations, transactions that are likely to be abusive, and also prevents *any* transfer of mortgaged property, which can burden pension plans. But in respondent's view, the prohibited transaction provisions allow transfers of property in satisfaction of funding obligations despite their high potential for abuse. It is hard to believe that Congress wanted to protect pension plans from dealing with mortgaged property, even if the contribution of the mortgaged property was in addition to the employer's satisfaction of its funding obligation, while allowing employers to discharge their funding obligations by contributing property to their pension plans.

C. In 1981, the Department of Labor concluded, in an opinion letter issued in a case similar in all pertinent respects to this case, that employers may not discharge their funding obligations by contributing property to pension plans. DOL Advisory Opinion 81-69A (July 28, 1981) (App., *infra*, 1a-3a). The other agencies that administer ERISA (the IRS and the PBGC) agree with the Department of Labor's construction of the prohibited transaction provisions. The government's construction

of Section 4975 is at least permissible (in our view, it is the most natural reading of the statute), and the government's interpretation of the statute is therefore entitled to deference.

ARGUMENT

THE CONTRIBUTION OF PROPERTY TO A DEFINED BENEFIT PENSION PLAN BY THE PLAN'S SPONSORING EMPLOYER, IN SATISFACTION OF THE EMPLOYER'S FUNDING OBLIGATION, CONSTITUTES A PROHIBITED "SALE OR EXCHANGE" OF THE PROPERTY UNDER 26 U.S.C. 4975(c)(1)(A)

Prior to the enactment of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829, the "arm's-length" standard of conduct governed transactions between pension plans and their sponsors. S. Rep. No. 383, 93d Cong., 1st Sess. 32 (1973). The arm's-length standard, however, "require[d] substantial enforcement efforts, resulting in sporadic and uncertain effectiveness." *Ibid.* Accordingly, employers sometimes were able to sell property to the pension plans they sponsored at inflated prices; alternatively, employers sometimes could satisfy their obligations to the pension plans they sponsored by contributing property that was overvalued or illiquid and depreciating. Such abuses put pension benefits at risk.

Congress responded to this problem in a number of ways. Most relevant to this case are the two parallel provisions Congress enacted in ERISA that replaced the arm's-length standard with a *categorical* rule barring employers from contributing property to pension plans instead of making required contributions in cash. See *Donovan v. Cunningham*, 716 F.2d 1455, 1464-1465 (5th Cir. 1983), cert. denied, 467 U.S. 1251 (1984) (the object of

the prohibited transaction provisions "was to make illegal per se the types of transactions that experience had shown to entail a high potential for abuse"). One of those provisions, Section 406(a)(1)(A) of ERISA, 29 U.S.C. 1106(a)(1)(A), prohibits the fiduciaries of employee benefit plans from engaging in any transaction that "constitutes a direct or indirect * * * sale or exchange * * * of any property" between the plan and its sponsoring employer.[9] In addition to remedies available against fiduciaries who violate Section 406 of ERISA, Congress also added Section 4975, the provision directly at issue in this case, to the Internal Revenue Code. Section 4975(c)(1)(A) imposes a heavy, two-tier tax (see note 3, *supra*) on employers who engage in "any direct or indirect * * * sale or exchange * * * of any property" with a pension plan they sponsor.

The court of appeals failed to construe Section 4975(c)(1)(A) in accordance with its broad language and the settled meaning of "sale or exchange," and instead eviscerated the provision. Focusing on Section 4975(f)(3)—which provides that a transfer of property to a plan "shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien"—the court limited the reach of Section 4975 to encumbered property. But Section 4975(f)(3) was intended to *broaden* the reach of the prohibited transaction provision to bar any contribution of mortgaged property, even if the contribution did not fulfill a funding obligation. Section 4975(f)(3) does not purport, and was not intended, to allow employ-

[9] Section 406 prohibits sales or exchanges with welfare plans as well as pension plans. For example, it prohibits the fiduciaries of collectively-bargained health plans, as well as the fiduciaries of pension plans, from accepting contributions of property instead of cash.

ers to sell property to pension plans by contributing unencumbered property, rather than cash, to satisfy their funding obligations.

A. The Contributions At Issue Were "Sale[s] Or Exchange[s]" Because They Satisfied Respondent's Funding Obligations

1. Section 4975(c)(1)(A) broadly prohibits "any direct or indirect * * * sale or exchange * * * of any property" between a pension plan and its sponsoring employer. It is well established under the Internal Revenue Code that the transfer of property in satisfaction of a monetary obligation, as occurred in this case when respondent transferred the truck terminals and the Key West property to the Pension Trust to satisfy its funding obligation, generally constitutes a "sale or exchange" of the property. See, *e.g.*, *Helvering* v. *Hammel*, 311 U.S. 504 (1941); ~~*Laport*~~ v. *Commissioner*, 671 F.2d 1028, 1033 (7th Cir. 1982); *Stamler* v. *Commissioner*, 145 F.2d 37, 39 (3d Cir. 1944); *Lakeside Irr. Co.* v. *Commissioner*, 128 F.2d 418, 419 (5th Cir.), cert. denied, 317 U.S. 666 (1942); *Burger-Phillips Co.* v. *Commissioner*, 126 F.2d 934, 935 (5th Cir. 1942); *Larus* v. *Commissioner*, 123 F.2d 254, 255 (2d Cir. 1941); *Pender* v. *Commissioner*, 110 F.2d 477, 478 (4th Cir.), cert. denied, 310 U.S. 650 (1940). Cf. *Commissioner* v. *Tufts*, 461 U.S. 300 (1983); *Crane* v. *Commissioner*, 331 U.S. 1 (1947). Similarly, the courts have held that a transfer of property to satisfy a bequest that was stated in dollar terms, a transaction not unlike a transfer of property in satisfaction of a funding obligation, is a "sale or exchange" of the property transferred. See *Kenan* v. *Commissioner*, 114 F.2d 217, 219-220 (2d Cir. 1940); *Brinckerhoff* v. *Commissioner*, 8 T.C. 1045, 1049 (1947), aff'd, 168 F.2d 436 (2d Cir. 1948). Accord, Rev. Rul. 67-74, 1967-1 C.B. 194.

The logic supporting the conclusion that a transfer of property in satisfaction of an obligation is a "sale or exchange" is straightforward: "When property is transferred in satisfaction of a debt, the transaction is functionally equivalent to a sale of the property for cash, coupled with a use of the proceeds to pay the debt." 2 B. Bittker, *Federal Taxation of Income, Estates and Gifts* para. 40.4, at 40-11 (1990); cf. *Pender* v. *Commissioner*, 110 F.2d at 478; *Burger-Phillips Co.* v. *Commissioner*, 126 F.2d at 936; *Kenan* v. *Commissioner*, 114 F.2d at 219; *Commissioner* v. *S.A. Woods Mach. Co.*, 57 F.2d 635, 636 (1st Cir.), cert. denied, 287 U.S. 613 (1932); *Rogers* v. *Commissioner*, 103 F.2d 790, 792-793 (9th Cir.), cert. denied, 308 U.S. 580 (1939); see also *Schultz* v. *Commissioner*, 59 T.C. 559, 565 (1973); S. Surrey, P. McDaniel, H. Ault & S. Koppelman, *Federal Income Taxation* 928 (Successor ed. 1986). Thus, respondent's contribution of the truck terminals and the Key West property amounted to a sale of the properties to the Pension Trust, with the proceeds used to satisfy respondent's funding obligation.[10]

[10] The transactions differed from sales to third parties, with the proceeds used to satisfy respondent's funding obligation, in three ways, each of which illustrates why Congress prohibited transfers of property by employers to pension plans. First, if an employer sells property to a third party and uses the proceeds to satisfy its funding obligation, there is no question concerning the value of the employer's contribution to the plan, since the contribution would be made in cash. But when property is transferred to a pension plan, so that there is no actual sale on an open market, there may be considerable doubt as to the actual value of the contribution. Second, if an employer sells property to a third party, the employer bears the transaction costs of the sale. By transferring

Accordingly, by transferring its truck terminals and the Key West property to the Pension Trust in satisfaction of its funding obligation, respondent effectively accomplished precisely what Section 4975(c)(1)(A) prohibits—selling those properties to the Pension Trust. Indeed, neither respondent nor the court of appeals has contended that the contribution of property to a pension plan in satisfaction of a debt is not a "sale or exchange" under the ordinary meaning of that phrase. And in *Wood*, the Fourth Circuit, which refused to depart from the well-settled rule in the tax law that a transfer of property in satisfaction of an obligation is a "sale or exchange," observed that it was "aware of no instance when the term 'sale or exchange' has been used or interpreted not to include transfers of property in satisfaction of indebtedness." Pet. App. 28a.

Contrary to the view of the court of appeals in this case, the judicial decisions construing "sale or exchange" are not "irrelevant" (Pet. App. 7a) because they arose under the income tax provisions of the Internal Revenue Code. To the contrary, the rationale of those decisions—that a transfer of property in fulfillment of a dollar obligation is a type of sale—is entirely applicable under Section 4975(c)(1)(A). Indeed, the phrase "sale or exchange" had acquired a settled judicial and administrative interpretation over the course of more than 50

property to the plan, an employer also transfers the transaction costs of disposing of the property. Third, if an employer contributes cash to a pension plan, the trustees of the plan may invest it as they consider most appropriate. But if property is contributed instead of cash, then the plan has been forced to invest in that property until the trustees liquidate the property and reinvest the proceeds, and the plan bears the risk of depreciation until the property is liquidated.

years before Congress enacted the even broader statutory language—embracing "*any* direct *or indirect* * * * sale or exchange"—in Section 4975 (emphasis added). Cf. *McWilliams* v. *Commissioner*, 331 U.S. 694 (1947). Congress was presumptively aware when it enacted Section 4975 that the phrase "sale or exchange" had consistently been construed to include the transfer of property in satisfaction of a monetary obligation. *Albernaz* v. *United States*, 450 U.S. 333, 341 (1981). In addition, the Commissioner's interpretation of the phrase "sale or exchange" comports with "[t]he normal rule of statutory construction * * * that 'identical words used in different parts of the same act are intended to have the same meaning' " (*Sorenson* v. *Secretary of the Treasury*, 475 U.S. 851, 860 (1986); see also *Ardestani* v. *INS*, 112 S. Ct. 515, 519 & n.2 (1991)), as well as this Court's admonition in *Commissioner* v. *Lester*, 366 U.S. 299, 304 (1961), that "the Code must be given 'as great an internal symmetry and consistency as its words permit.' " Accordingly, it is proper to turn first to the settled meaning of "sale or exchange" when construing Section 4975(c)(1)(A).

But even if "sale or exchange" had not had a settled meaning under the Internal Revenue Code, it would be clear that Section 4975(c)(1)(A) prohibits the transfer of property in satisfaction of a debt. Congress did not merely prohibit a "sale or exchange," it barred "any direct or indirect * * * sale or exchange" between employers and the pension plans they sponsor. At the least, the contribution of property in satisfaction of a funding obligation is a type of sale of the property. It is equally surely a form of exchange, since the property is exchanged for diminution of the employer's funding obligation.

2. Construing Section 4975(c)(1)(A) in accordance with its broad language and the settled meaning of "sale or exchange" is necessary to accomplish Congress's goal in enacting the provision, which was to bar categorically transactions that are likely to injure pension plans. S. Rep. No. 383, *supra*, at 95-96. The transfer of property to a pension plan in satisfaction of a funding obligation can jeopardize the ability of the plan to pay promised benefits, and Congress sought to eliminate that possibility by enacting Section 4975 of the Code and Section 406 of ERISA. Just as a disqualified person may directly sell property to a plan for more than its fair market value, thereby putting in jeopardy the plan's ability to pay promised benefits, an employer may overstate the value of property contributed in satisfaction of a funding obligation and similarly jeopardize the plan's ability to pay promised benefits. Preventing the possibility that such a non-arm's-length transaction might go undiscovered or uncorrected was one the principal purposes of Section 4975(c). S. Rep. No. 383, *supra*, at 32.

The facts of *Wood*—the Fourth Circuit decision that conflicts with the decision of the Fifth Circuit in this case—illustrate the potential for abuse. In that case, three promissory notes were contributed to a pension plan and valued at $114,000 "although the total fair market value of the notes at the time they were transferred to the plan was only $94,430." Pet. App. 20a. In effect, the taxpayer in *Wood* caused the plan to purchase the notes at prices substantially higher than the plan would have had to pay on the open market, if the trustee of the plan had chosen to purchase such notes. *Id.* at 25a. Short of conducting a transaction-by-transaction analysis of every contribution of property to a pension plan, which Congress sought to avoid by enacting categorical

prohibited transaction rules, there can be no assurance that insiders will deal with the pension funds in an arm's-length manner and in the best interest of the pension plan.

Nor does the potential for abuse end with the possibility of overstatements of value. Under the court of appeals' holding in this case, an employer who owns real property located in a depreciating area, or other problem or illiquid investments that it cannot readily sell, may contribute that property at its appraised fair market value to a plan, thereby using the plan as a convenient buyer. Even if the property is not overvalued, the pension plan then would bear the burden of disposing of the property.

Furthermore, it is the plan's fiduciaries who are responsible for prudent investment of the trust fund's assets. By contributing property in satisfaction of a plan's funding requirements, the employer attempts to impose its judgment as to the investment policies of the trust fund for the judgment of the persons who rightfully have that responsibility.[11]

The facts of this case illustrate the potentially harmful effects of prohibited transfers of property to a pension plan even when the property is not overvalued. The exclusive sales listing agreements that respondent had en-

[11] If contributions of property were allowed, trustees of pension plans would have to examine the prudence of accepting each contribution. But in our view, Congress did not intend to rely on such individualized applications of the prudent man investment standard (see 29 U.S.C. 1104) to sales of property by employers to the plans they sponsor—such a requirement would be costly and burdensome. Instead, it meant to prohibit such transfers altogether whenever they amount to a "sale or exchange" or the transferred property was encumbered.

tered into on two of the truck terminals called for the payment of sales commissions of at least five percent, which shows that it is neither easy nor costless to dispose of such property. See Affidavit of James Stanis, Exhs. E.3, E.4. Respondent transferred the cost of disposing of the properties to the plan when it contributed the properties to the plan. Moreover, having invested in the properties, the plan trustees could not easily dispose of them: the Chicago truck terminal was listed for sale by the Pension Trust on June 17, 1983, soon after it was received from respondent, but it was not sold for three and one-half years. *Id.*, Exhs. H, I, and J.

The court of appeals suggested that all of these problems were solved by 26 U.S.C. 4971, which imposes an excise tax on employers whose plans are underfunded. Pet. App. 8a. But Section 4975 was enacted to eliminate the need for case-by-case evaluations of transactions between pension plans and insiders, thereby preventing potentially abusive transactions from occurring, which in turn would prevent pension plans from *becoming* underfunded. S. Rep. No. 383, *supra*, at 32. That Section 4975(c)(1)(A) imposes a categorical rule is clear from the language of the statute. For example, an ordinary sale of property by an employer to a pension plan clearly is prohibited by Section 4975(c)(1)(A) even if it is undisputed that the plan paid fair market value for the property. See, *e.g.*, *Leib* v. *Commissioner*, 88 T.C. 1474, 1481 (1987) ("[t]he fact that the transaction would qualify as a prudent investment when judged under the highest fiduciary standards is of no consequence"). Section 4971, by contrast, imposes a tax on accumulated funding deficiencies that have already occurred, whether caused

by plan losses, insider transactions, or otherwise. Thus, the focus of each of the two provisions is very different.

Moreover, Section 4971, by itself, does not fully address the underfunding problem. The underfunding of the plan, and thus the possible application of Section 4971, often becomes evident only when overvalued property is ultimately sold. If this takes a number of years (as it did in this case), the employer will have underfunded the pension plan for that period of time and may have escaped liability for any penalty. Even if the property is not overvalued, the plan may incur sales costs in disposing of the property and therefore ultimately receive less than the credit that the employer took for the contribution. Furthermore, if the pension plan fails while it is still holding the property, the employer will have escaped application of Section 4971, and will have saddled the Pension Benefit Guaranty Corporation (PBGC) with the hidden shortfall.[12] And since the level of benefits guaranteed by the PBGC is limited, participants and beneficiaries may suffer actual losses due to the underfunding. See 29 U.S.C. 1322, 1322a. Section 4975, and not Section 4971, prevents these abuses.

B. The Court Of Appeals Erred By Concluding That Section 4975(f)(3) Limits The Meaning Of "Sale Or Exchange" In Section 4975(c)(1)(A)

1. The court of appeals interpreted "sale or exchange" in Section 4975(c)(1)(A) contrary to its ordinary, settled meaning primarily as a result of its erroneous construction of Section 4975(f)(3). That provision states, in pertinent part, that "[a] transfer [of] real or personal property

[12] The amicus brief filed by the PBGC provides a number of examples of cases where it has assumed responsibility for underfunded plans holding overvalued property.

by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien." The court of appeals called Section 4975(f)(3) a "definition" and read it as "implying that unless [property] is encumbered by a mortgage or lien, a transfer of property is not to be treated as if it were a sale or exchange." Pet. App. 5a.[13]

In *Wood*, the Fourth Circuit expressly disagreed with the construction given to Section 4975(f)(3) by the Fifth Circuit, and instead agreed with the Commissioner that Section 4975(f)(3) "serves the special need of expanding the scope of prohibition when *encumbered* property is involved." Pet. App. 28a. Thus, the Fourth Circuit held that Section 4975(f)(3) does not restrict the meaning of "sale or exchange" in Section 4975(c)(1)(A). The Fourth Circuit gave Section 4975(f)(3) its more natural reading, and the one that is more logical in the statutory context.

Section 4975(f), which has five subsections, sets out "other definitions and special rules" for purposes of Section 4975. Three of those subsections (subsections (f)(2), (f)(4), and (f)(5)) provide definitions (for "taxable period," "amount involved," and "correction" and "correct"). Section 4975(f)(3) does not purport to define "sale or exchange." It instead contains a "special rule."[14] The statutory text at issue—providing that a transfer of encumbered property "shall be treated as" a sale or exchange—supports the Fourth Circuit's view that Congress intended Section 4975(f)(3) to expand the scope of the prohibited transaction provision. The phrase "shall be treated as" necessarily recognizes that another subsection (Section 4975(c)(1)(A)) prohibits "sales or exchanges," and specifies that transfers of encumbered property "shall be treated as" a sale or exchange even when they would not qualify as a "sale or exchange" under Section 4975(c)(1)(A). Thus, Section 4975(f)(3) amplifies and extends the reach of "sale or exchange" in Section 4975(c)(1)(A) to include contributions of encumbered property that do not satisfy funding obligations.

The legislative history confirms that Congress understood Section 4975(f)(3) to enlarge, rather than restrict, the reach of the prohibited transaction provision. The Conference Report first stated that "the direct or indirect sale, exchange, or leasing of any property between the plan and a party-in-interest * * * is a prohibited transaction." H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 307 (1974). "Also," the report continued, "following the private foundation rules of the tax law, a transfer of property by a party-in-interest to a plan is treated as a

[13] If Section 4975(f)(3) actually defined "sale or exchange" for purposes of Section 4975, and limited that definition to transfers of encumbered property, then that would mean that employers could directly sell unencumbered property to their pension plans for cash. We doubt that the court meant to suggest that extreme result. Rather, we understand the court to have held that Section 4975(f)(3) creates a negative implication limited to contributions of property, not sales for cash.

[14] The fact that Section 4975(f)(3) contains a "special rule" rather than a "definition" of "sale or exchange" is confirmed by the contrast between it and subsections (f)(2), (f)(4), and (f)(5), each of which begins "[t]he term '___' means." In addition, as we explain at page 28, *infra*, Section 4975(f)(3) was modeled on 26 U.S.C. 4941(d)(2)(A), part of the provision governing contributions to private foundations, and Section 4941(d)(2) sets out "special rules," while another subsection (Section 4941(e)) contains "definitions."

sale or exchange if the property is subject to a mortgage or a similar lien." *Id.* at 308. Thus, Congress intended Section 4975(f)(3) to provide additional protection, not to limit the protection provided by Section 4975(c)(1)(A).

2. In support of its construction of Section 4975(f)(3), the court of appeals opined that the government's construction renders the provision "superfluous." Pet. App. 5a. The court was mistaken. It focused exclusively on defined *benefit* pension plans (see note 1, *supra*), and concluded that *any* transfer of property to such a plan would qualify as a "sale or exchange" under the normal meaning of that phrase. The court reasoned that, even if the value of the contribution exceeded the employer's current funding obligation, the contribution would satisfy a future funding obligation.[15] The court did not appreciate the fact that many employers sponsor defined *contribution* pension plans, such as profit-sharing plans. Some profit-sharing plans do not mandate any contributions, but instead specify how any contributions that are made are to be distributed among plan participants. An employer is not barred by Section 4975(c)(1)(A) from contributing property to such a plan, because the contribution of property to such a plan does not satisfy any obligation to the plan. Nor would an employer be barred by

[15] As a practical matter, the treatment of payments to defined benefit pension plans in excess of those required to satisfy current funding obligations is largely a nonissue. Section 4972 imposes an excise tax on contributions to defined benefit pension plans that are not deductible, and Section 404 generally limits deductible contributions to such plans to amounts necessary to satisfy the employer's minimum funding obligation and the amortization of past unfunded liabilities to the plan. See Kirschbaum, *Investment of Pension Plan Assets: Selected Unrelated Business Taxable Income and Prohibited Transaction Issues*, 44 U.S.C. Annual Tax Inst. (Major Tax Planning) ¶ 901.6, at 9-48 (Univ. S. Cal. 1992).

Section 4975(c)(1)(A) from contributing property to a profit-sharing plan that provided that a certain percentage of profits was to be contributed each year, if the property were contributed on top of a cash contribution of the mandated share of profits. DOL Advisory Opinion 90-05A (Mar. 29, 1990). But Section 4975(f)(3) bars contributions of *encumbered* property in all these circumstances, even though such a contribution would not be a "sale or exchange" under Section 4975(c)(1)(A).

Respondent has also argued that the Commissioner's reading of Section 4975(c)(1)(A) renders Section 4975 (f)(3) superfluous. Its argument is based on the fact that "*all* transfers of property from an employer to a plan, *whether voluntary or in satisfaction of a debt*, are treated as 'sales or exchanges' under the income tax laws." Br. in Opp. 8. Thus, respondent contends, if the meaning of "sale or exchange" in Section 4975(c)(1)(A) is based on the meaning of "sale or exchange" under the income tax laws, Section 4975(f)(3) serves no purpose. Respondent overlooks the language of Section 4975(c)(1)(A), which is somewhat different from the language of the income tax provisions. For example, 26 U.S.C. 1001(c), a key income tax provision, speaks of the "sale or exchange of property" without qualification. See also 26 U.S.C. 1222. Section 4975(c)(1)(A), on the other hand, prohibits a "sale or exchange * * * of any property *between a plan and a disqualified person*" (emphasis added). A contribution of property that does not satisfy a funding obligation is generally treated as a "sale or exchange" under the income tax rules (and hence the employer must recognize any gain) because it is a "sale or exchange" *between the employer and its employees*, since the contribution generally is made in consideration of the employees' labor (rather than as a gift). See, *e.g.*,

Tasty Baking Co. v. *United States*, 393 F.2d 992, 994-995 (Ct. Cl. 1968); Rev. Rul. 75-498, 1975-2 C.B. 29, 30. But such a contribution is not a sale or exchange *between the employer and the pension plan*, since it does not satisfy an obligation of the employer to the plan. Thus, the language of Section 4975(c)(1)(A) makes clear that not every transaction that is a "sale or exchange" under the income tax rules is also a "sale or exchange" under Section 4975.

3. The Commissioner's construction of Section 4975—that it bars all contributions of property except contributions of unencumbered property that do not satisfy any obligation to a plan—is logical. Transfers of encumbered property have potential to burden a plan, and contributions of any sort of property in satisfaction of a funding obligation are likely to harm a plan. But a transfer of unencumbered property that does not satisfy a debt presents little potential for causing plan losses. Respondent's construction of Section 4975, by contrast, is contrary to common sense. While its reading of Section 4975(f)(3) protects plans from the burdens of disposing of encumbered property, even if the transfer of the encumbered property would benefit the plan, respondent reads Section 4975(f)(3) to undo the protection provided by Section 4975(c)(1)(A). Thus, in respondent's view Section 4975 prophylactically protects plans from encumbered property, while at the same time permitting employers to satisfy their funding obligations by transferring unencumbered property, despite the major potential for abuse inherent in such transactions.[16]

[16] Recognizing that the prohibited transaction rules it was enacting were exceptionally broad, Congress provided an administrative exemption procedure pursuant to which the Secretary of the Treasury and the Secretary of Labor are permitted to grant

Moreover, if Congress had wanted to allow employers to satisfy their funding obligations by contributing unencumbered property to pension plans, the logical place to make that clear in the statute would have been in Section 4975(d), the statutory exemption provision, rather than by negative implication from a "special rule" in Section 4975(f). *Cf. Ingersoll-Rand Co.* v. *McClendon*, 111 S. Ct. 478, 484 (1990) ("[h]ad Congress intended to restrict ERISA's pre-emptive effect to state laws purporting to regulate plan terms and conditions, it surely would not have done so by placing the restriction in an adjunct definition section while using the broad phrase 'relate to' in the preemption section itself"). In fact, Congress established an exemption in Section 4975(d)(13) which, among other things, allows employers to contribute stock to pension plans in certain circumstances. That exemption supports our contention that Section 4975(c)(1)(A) generally prohibits contributions of unencumbered property (such as stock). It also shows that Congress placed exemptions to Section 4975(c)(1)(A) in the "exemption" provision, not in the "other definitions and special rules" provision.

conditional or unconditional exemptions from the prohibited transaction rules. 26 U.S.C. 4975(c)(2); 29 U.S.C. 1108. In order to grant an exemption, the Secretaries must conclude "that the transaction is in the interests of the plan and its participants and beneficiaries, that it does not present administrative problems, and that adequate safeguards are provided for participants and beneficiaries." H.R. Conf. Rep. No. 1280, *supra*, at 311; see also 29 U.S.C. 1108(a); 29 C.F.R. 2570.30-2570.52 (1991). Under respondent's reading of Section 4975, however, a transfer of unencumbered property in satisfaction of an obligation is not subject to administrative examination to determine whether it is in the best interests of the plan; rather, such transfers are not barred at all.

4. The court of appeals also read Section 4975(f)(3) out of its historical context. Section 4975 was modeled on Section 4941, which deals with contributions to private foundations. See S. Rep. No. 383, *supra*, at 98 (in enacting Section 4975, Congress intended to "follow[ ] the private foundation rules"). Section 4941 contains provisions nearly identical to Sections 4975(c)(1)(A) and 4975(f)(3).[17] Like Section 4975(c)(1)(A), Section 4941(d)(1)(A) defines "self-dealing" to include the "sale or exchange * * * of property between a private foundation and a disqualified person." Like Section 4975(f)(3), Section 4941(d)(2)(A) provides, as a "special rule," that a transfer of property by a disqualified person to a private foundation "shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien."[18] Contributions of property to private foundations typically are *not* made in satisfaction of legal obligations but, rather, are gifts. Hence, it is clear that the central function of Section 4941(d)(2)(A), the provision that is analogous to Section 4975(f)(3), was to expand the definition of "sale or exchange" in order to establish that the voluntary transfer of encumbered property to private foundations constitutes a prohibited "sale or exchange" of the property transferred.

[17] The reasons for enacting Section 4941 were virtually identical to those later given by Congress for enacting Section 4975. Prior to 1969, self-dealing transactions between private foundations and disqualified persons were prohibited only if the transactions did not satisfy an "[a]rm's-length standard[ ]." S. Rep. No. 552, 91st Cong., 1st Sess. 28 (1969). As the Senate Finance Committee stated in enacting Section 4941, "[a]rm's-length standards have proved to require disproportionately great enforcement efforts, resulting in sporadic and uncertain effectiveness of the provisions." S. Rep. No. 552, *supra*, at 28-29.

[18] The court of appeals mistakenly stated that "Section 4941 * * * contains no definition of a sale or exchange as found in Section 4975(f)(3)." Pet. App. 8a. (We, of course, disagree that those parallel provisions constitute "definitions.")

C. The Agencies That Administer ERISA Have Reasonably Concluded That Employers May Not Fulfill Their Funding Obligations By Contributing Property To Pension Plans

An agency's construction of a statute that it is charged with administering is entitled to considerable weight. *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-843 (1984). This Court and others have recognized that this rule is particularly applicable with respect to ERISA. *Mead Corp.* v. *Tilley*, 490 U.S. 714, 726 (1989) ("[f]or a court to attempt to answer these questions without the views of the agencies responsible for enforcing ERISA, would be to 'embar[k] upon a voyage without a compass'" (citation omitted)); *Blessitt* v. *Retirement Plan for Employees of Dixie Engine Co.*, 848 F.2d 1164, 1167 (11th Cir. 1988) ("we owe great deference to the interpretations and regulations of the Pension Benefit Guaranty Corporation ('PBGC'), the Internal Revenue Service ('IRS') and the Department of Labor, which are the administrative agencies responsible for enforcing and interpreting ERISA"); *Rose* v. *Long Island R.R. Pension Plan*, 828 F.2d 910, 918 (2d Cir. 1987), cert. denied, 485 U.S. 936 (1988) ("[b]ecause the IRS is one of the agencies charged with administering ERISA, its interpretations of the statute are entitled to great deference").

When it enacted parallel prohibited transaction provisions in Title 26 and Title 29, Congress stated that, "[t]o the maximum extent possible, the prohibited transaction rules are identical in the labor and tax provisions, so

they will apply in the same manner to the same transaction." H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 295-296 (1974). To ensure consistency, the Department of Labor has primary authority to construe both sets of prohibited transaction rules. Reorg. Plan No. 4 of 1978, § 102, 92 Stat. 3790. In DOL Advisory Opinion 81-69A (July 28, 1981) (App., *infra*, 1a-3a), the Department addressed the precise issue presented in this case and ruled that a sponsoring employer's transfer of unencumbered property to a pension plan to satisfy its funding obligation was a prohibited "sale or exchange." The ruling concluded that such a transaction "constitutes a discharge by the Employer of its legal obligation to make the contribution for that year," so that "[i]n effect, the Plan is exchanging its legal rights to payment of the contribution for property other than cash." App., *infra*, 2a. The Department explained that "no inference should be drawn from the rule [barring contributions of encumbered property] that a contribution of property by an employer, in discharge of its legal obligation to contribute, would be permissible." *Id.* at 2a-3a. Accord, DOL Advisory Opinion 90-05A (Mar. 29, 1990).[19] The other agencies that administer ERISA join that conclusion, which the Commissioner urges this Court to adopt in this case.[20]

[19] In DOL Advisory Opinion 90-05A, the Department concluded that where the contribution of "property to the Plan is purely voluntary, and will not relieve the Employer of any obligation to make a cash contribution to the Plan," it "would not constitute a prohibited transaction." App., *infra*, 6a.

[20] The court of appeals in this case declined to accord any significance to the advisory opinions of the Department of Labor because such opinions are binding only on the parties. Pet. App. 7a-8a. But advisory opinions of the Department of Labor constitute official expressions of the Department's position respecting ERISA and have been so treated by the courts. See, *e.g.*, *Massachusetts* v. *Morash*, 490 U.S. 107, 118 n.14 (1989); *Fraver* v. *North Carolina Farm Bureau Mutual Insurance Co.*, 801 F.2d 675, 677-678 (4th Cir. 1986); *Shea* v. *Wells Fargo Armored Service Corp.*, 810 F.2d 372, 376 (2d Cir. 1987). Accordingly, opinions expressed in such pronouncements fall within the rule that an agency's construction of a statute that it is charged with administering is entitled to considerable weight. Indeed, consistent with the relevant authority on this issue, the Fifth Circuit recently acknowledged (after it issued its decision in this case) that "DOL opinions 'constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance,'" *MDPhysicians & Associates, Inc.* v. *State Board of Insurance Co.*, 957 F.2d 178, 186 n.9, cert. denied, 113 S. Ct. 179 (1992), quoting *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944), and that it "consider[s] the opinions of the Department of Labor of persuasive value" (957 F.2d at 186 n.9).

It is also instructive that the Internal Revenue Service has accorded the same meaning to the phrase "sale or exchange" in interpreting Section 4941 of the Internal Revenue Code, the provision upon which Section 4975 was modeled. S. Rep. No. 383, *supra*, at 32; H.R. Conf. Rep. No. 1280, *supra*, at 306. In Rev. Rul. 81-40, 1981-1 C.B. 508, a disqualified person attempted to correct an act of self-dealing (the borrowing of money from a private foundation) by transferring real estate to the private foundation in cancellation of the indebtedness. The IRS ruled that the transfer of the property in satisfaction of the indebtedness would constitute a second act of self-dealing, because the transfer of the property in satisfaction of the indebtedness would be a sale of property within the meaning of Section 4941. Similarly, in Rev. Rul. 77-379, 1977-2 C.B. 387, the Service ruled that the transfer of stock by a private foundation in repayment of a loan by a disqualified person was "tantamount

to a sale or exchange of property between a private foundation and a disqualified person within the meaning of section 4941(d)(1)(A)."[21]

At the least, the agencies that administer ERISA have construed Section 4975 reasonably. Accordingly, the Fourth Circuit in *Wood* properly gave considerable weight to the interpretation of those agencies. Pet. App. 28a-29a. This Court should do the same, particularly since the administrative construction of the phrase "any direct or indirect * * * sale or exchange" in Section 4975(c)(1)(A) is straightforward and is the only one that comports with the statutory context and with the expressed congressional intent.

[21] See also Treas. Reg. § 1.415-6(b)(4), which, in the context of a defined contribution plan, warns that a contribution of property may "constitute a prohibited transaction within the meaning of section 4975(c)(1)."

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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NOVEMBER 1992

DEPARTMENT OF LABOR
PENSION & WELFARE BENEFIT PROGRAMS
OPINION 81-69A
JULY 28, 1981

OPINION:

This is in reply to your letter of June 19, 1980, in which you requested a ruling that the contribution by an employer of an option to a defined benefit plan does not violate section 4975 of the Internal Revenue Code. For purposes of our reply, all references to the Code contained in your letter will be treated as references to corresponding provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

You represent that Conahan & Conahan, Attorneys at Law, A Law Corporation (the Employer) established the Conahan & Conahan, Attorneys at Law, A Law Corporation Defined Benefit Pension Plan (the Plan) and that the Plan received a favorable determination letter from the Internal Revenue Service in July 1970. The Plan is a defined benefit plan. The Employer holds an option to purchase a residential condominium unit which it acquired from James P. Conahan and Kathleen K.O. Conahan, the apparent owners of the unit. As part of its corporate contribution to the Plan, the Employer wishes to make a contribution of the option to the Plan.

Section 406(a)(1)(A) of ERISA provides that a fiduciary with respect to a plan shall not cause a plan to engage in a transaction, if he knows or should know that such a transaction constitutes a direct or indirect sale or exchange between a plan and a party in

interest. Section 3(14)(C) provides that a party in interest means an employer any of whose employees are covered by the plan. An employer assumes with respect to a defined benefit plan an obligation to make contributions to fund promised benefits. The contribution of the option by the Employer to the Plan constitutes a discharge by the Employer of its legal obligation to make the contribution for that year. In effect, the Plan is exchanging its legal right to payment of the contribution for property other than cash. Accordingly, the contribution of the option by the Employer is a prohibited sale or exchange of property between a plan and a party in interest under section 406(a)(1)(A) of ERISA.

You argue that section 406(c) of ERISA compels the conclusion that only encumbered contributions of real or personal property by an employer are prohibited by section 406(a)(1)(A). Section 406(c) provides that a *transfer* of real or personal property by a party in interest to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or lien which the plan assumes or it is subject to a mortgage or similar lien which a party in interest placed on the property within the 10 year period ending on the date of the transfer (emphasis added). Following the private foundation rules of the tax law applicable to gifts of property to private foundations, this rule prevents a party in interest from circumventing the section 406(a)(1)(A) prohibition on sales or exchanges by getting a loan on the property and donating it to a plan which must either pay off the loan or give up the property. See Conference Report 93-1280, 93rd Congress, 2d Sess., at 308. The applicability of the rule is limited to voluntary transfers of property which Congress considered to be sales or exchanges and no inference should be drawn from the rule that a

contribution of property by an employer, in discharge of its legal obligation to contribute, would be permissible.

In addition, you should be aware that, based on your letter, it appears that the exercise of the option by the Plan might also constitute a violation of section 406(a)(1)(A) of ERISA.

This letter constitutes an advisory opinion under ERISA Procedure 76-1 (issued August 27, 1976). Accordingly, it is issued subject to the provisions of the procedure, including section 10 thereof relating to the effect of advisory opinions.

Alan D. Lebowitz
Assistant Administrator for Fiduciary Standards
Pension and Welfare Benefit Programs

APPENDIX B

DEPARTMENT OF LABOR
PENSION & WELFARE BENEFITS ADMINISTRATION
OPINION 90-05A
MARCH 29, 1990

OPINION:

This is in response to your letter of January 5, 1989, in which you requested an advisory opinion regarding the application of the prohibited transaction provisions of the Employee Retirement Income Security Act of 1974 (ERISA) to a contribution by an employer of real property to an employee stock ownership plan.

You represent that the Edelbrock Corporation Employee Stock Ownership Plan, Stock Bonus Portion (the Plan) is a stock bonus plan qualified under section 401(a) of the Internal Revenue Code of 1986 (the Code). The Plan, in conjunction with a money purchase pension plan, is intended to constitute an employee stock ownership plan under section 407(d)(6) of ERISA. As an employee stock ownership plan, the Plan is designed to invest primarily in stock of the Edelbrock Corporation (the Employer).[1]

You further represent that the Board of Directors has resolved to contribute two light industrial commercial buildings owned by the Employer to the Plan. The properties (known as Building #4 and Building #8) are located in the Edelbrock Chandler Business Park, Chandler, Arizona. The buildings are currently owned outright by the Employer, i.e., there are no mortgages or other liens against them. The properties are tenant occupied subject to transferable leases expiring in 1991, and they are valued based on independent MIA appraisal taking into account the value of the existing leases. The contribution will not create any ongoing relationship between the Plan and a party in interest. Subsequent to the proposed contribution, real estate will comprise 10.4 percent of plan assets, cash and cash equivalents 5.2 percent, and qualifying employer securities will make up the remaining 84.4 percent of plan assets.

[1] In this regard, you indicate that the Plan has not borrowed funds in order to finance the purchase of employer securities under section 408(b)(3) of ERISA.

According to your representations, the Plan is funded at the discretion of the Board of Directors. The proposed contribution is purely voluntary, and would not relieve the Employer of an obligation to make a cash contribution to the Plan. In this regard, you have specifically represented that the proposed contribution of real property is not a substitute for a previously resolved cash contribution, and that no part of the contribution will be used to satisfy any required contribution to the related money purchase plan.

In effect, you request the following opinions:

1) that the contribution of real property to the Plan will not violate section 406 of ERISA, and

2) that the investment of 15.6 percent of the Plan's assets in investments other than qualifying employer securities will satisfy the requirement that an employee stock ownership plan be "designed to invest primarily in qualifying employer securities" for purposes of section 407(d)(6) of ERISA.

Section 406(a)(1)(A) of ERISA provides that a fiduciary with respect to a plan shall not cause a plan to engage in a transaction if he knows or should know that such transaction constitutes a direct or indirect sale or exchange, or leasing, of any property between a plan and a party in interest. Section 3(14) of ERISA

defines a "party in interest" to include a fiduciary, a person providing services to a plan, and an employer any of whose employees are covered by such plan.

With respect to the first issue, the Department of Labor (the Department) addressed the issue of employer contributions in kind in Advisory Opinion 81-69A (July 28, 1981). In that Opinion, the Department concluded that a contribution of unencumbered property by an employer to a defined benefit plan would be a prohibited transaction under section 406(a)(1)(A) of ERISA because the contribution of such property discharged the employer of its legal obligation to make cash contributions to the plan. In effect, the plan would be exchanging its legal right to the payment of the contribution for property other than cash.

In the Department's view, contributions in kind that relieve an employer of an obligation to make cash contributions to any plan subject to Title I of ERISA, including an employee stock ownership plan, are prohibited exchanges under section 406(a)(1)(A) of ERISA. If, however, an employer's contribution in kind is purely voluntary, it is the Department's further view that such contributions in kind would not be prohibited under section 406(a)(1)(A) of ERISA.

You represent that the contribution of the real property to the Plan is purely voluntary, and will not relieve the Employer of any obligation to make a cash contribution to the Plan. Based upon the facts and representations contained in your submission, it is the view of the Department that the contribution of real property to the Plan would not constitute a prohibited transaction under section 406(a)(1)(A) of ERISA.

With respect to the second issue, the term "employee stock ownership plan" is defined under section 407(d)(6) of ERISA to mean an individual account plan which is (i) a stock bonus plan which is qualified, or a stock bonus plan and a money purchase plan both of which are qualified, under section 401 of the Code, and (ii) is designed to invest primarily in qualifying employer securities, and (iii) meets such other requirements as the Secretary of the Treasury may prescribe by regulation.

29 CFR § 2550.407d-6(a)(2) of the Department's regulations provides that to be an ESOP, a plan must be formally designated as such in the plan documents. 29 CFR § 2550.407d-6(b) further provides that a plan constitutes an ESOP only if a plan specifically states that it is designed to invest primarily in qualifying employer securities. Although the regulation does not define the term "primarily," the regulation does state that a stock bonus plan or a money purchase pension plan constituting an ESOP may invest part of its assets in other than qualifying employer securities. In Advisory Opinion 83-6A (January 24, 1983), the Department stated that neither ERISA nor the applicable regulations promulgated thereunder contain maximum or minimum percentages of plan assets which must be invested in qualifying employer securities over the life of the ESOP in order to satisfy the "primarily" requirement of section 407(d)(6) of ERISA. The Department concluded that a plan provision requiring the plan to invest more than 50 percent of its assets in qualifying employer securities would not, in itself, contravene the requirement of ERISA section 407(d)(6) that an ESOP invest primarily in qualifying employer securities. [2]

[2] In this regard, we note that Advisory Opinion 83-6A emphasized the Department's belief that, in order to satisfy the ESOP requirements imposed by ERISA and applicable regulations, a plan must satisfy the "primarily" requirement of section 407(d)(6) over the life of the plan.

Accordingly, it is the responsibility of the appropriate plan fiduciaries to determine, based on all of the relevant facts and circumstances, the composition of the plan's portfolio, including the percentage of plan assets to be invested in qualifying employer securities in any particular instance. In this regard, we note that compliance with a plan provision would not insulate the fiduciaries from liability under section 404 of ERISA should prudence or exclusive benefit requirements dictate an alternative investment course of action.

The Department notes that ERISA's general standards of fiduciary conduct would apply to your proposed contribution in kind. Section 404(a)(1)(B) of ERISA requires that a fiduciary discharge his duties to a plan solely in the interests of the participants and beneficiaries, and with care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man would use in the conduct of an enterprise of a like character and with like aims. Accordingly, the fiduciaries of the Plan must act "prudently" and "solely in the interest" of the Plan's participants and beneficiaries when deciding whether to accept the contributions in kind. If accepting the contribution of the property by the Plan is neither "prudent" nor "solely in the interest" of the Plan's participants and beneficiaries, the fiduciaries of the Plan would be liable for any loss resulting from such breach of fiduciary responsibility, even though the contribution of the real property may not constitute a prohibited transaction under section 406 of ERISA.

This letter constitutes an advisory opinion under ERISA Procedure 76-1. Accordingly it is issued subject to the provisions of the procedure, including section 10 thereof, relating to the effect of advisory opinions.

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Director of Regulations and Interpretations